

## Highlights

|   | Three months ended    |                | Years ended May 31,    |                |
|---|-----------------------|----------------|------------------------|----------------|
|   | May 31,               |                |                        |                |
|   | 2009                  | 2008           | 2009                   | 2008           |
|   | <i>(unaudited)</i>    |                | <i>(audited)</i>       |                |
| <b>Operating</b>                        |                       |                |                        |                |
| Total Sales Volumes                     |                       |                |                        |                |
| Oil and NGLs (Bbls)                     | -                     | 730            | <b>1,120</b>           | 730            |
| Natural gas (Mcf)                       | <b>64,395</b>         | 93,108         | <b>205,991</b>         | 259,880        |
| Barrels of oil equivalent (Boe @ 6:1)   | <b>10,733</b>         | 16,248         | <b>35,452</b>          | 44,403         |
| Daily Sales Volumes                     |                       |                |                        |                |
| Oil and NGLs (Bbls/d)                   | -                     | 5              | <b>3</b>               | 2              |
| Natural gas (Mcf/d)                     | <b>700</b>            | 1,012          | <b>564</b>             | 712            |
| Barrels of oil equivalent (Boe/d @ 6:1) | <b>117</b>            | 174            | <b>97</b>              | 120            |
| Prices                                  |                       |                |                        |                |
| Oil and NGLs (per Bbl)                  | \$ -                  | \$ 59.90       | \$ <b>114.60</b>       | \$ 59.90       |
| Natural gas (per Mcf)                   | \$ <b>3.70</b>        | \$ 5.99        | \$ <b>6.29</b>         | \$ 4.93        |
| Revenue (per Boe)                       | \$ <b>22.19</b>       | \$ 37.04       | \$ <b>40.15</b>        | \$ 48.99       |
| Royalties (per Boe)                     | \$ <b>3.01</b>        | \$ 8.01        | \$ <b>6.45</b>         | \$ 14.32       |
| Operating costs (per Boe)               | \$ <b>10.89</b>       | \$ 2.95        | \$ <b>9.79</b>         | \$ 5.80        |
| Operating netback (per Boe)             | \$ <b>8.29</b>        | \$ 26.08       | \$ <b>23.91</b>        | \$ 28.87       |
| <b>Financial</b>                        |                       |                |                        |                |
| Oil and gas revenues                    | \$ <b>238,128</b>     | \$ 601,819     | \$ <b>1,423,450</b>    | \$ 1,327,277   |
| Funds used in operations                | \$ <b>(619,344)</b>   | \$ (492,301)   | \$ <b>(884,659)</b>    | \$ (1,438,270) |
| Per share – basic and diluted           | \$ <b>(0.01)</b>      | \$ (0.01)      | \$ <b>(0.02)</b>       | \$ (0.04)      |
| Cash flow used in operations activities | \$ <b>(252,338)</b>   | \$ (790,580)   | \$ <b>(351,790)</b>    | \$ (1,491,682) |
| Per share – basic and diluted           | \$ <b>(0.00)</b>      | \$ (0.02)      | \$ <b>(0.01)</b>       | \$ (0.04)      |
| Net loss                                | \$ <b>(3,495,667)</b> | \$ (1,221,339) | \$ <b>(11,183,703)</b> | \$ (3,181,762) |
| Per share – basic and diluted           | \$ <b>(0.07)</b>      | \$ (0.03)      | \$ <b>(0.25)</b>       | \$ (0.09)      |
| Working capital deficiency              | \$ <b>(2,908,416)</b> | \$ (3,812,842) | \$ <b>(2,908,416)</b>  | \$ (3,812,842) |
| Capital expenditures                    | \$ <b>(132,606)</b>   | \$ 790,379     | \$ <b>1,241,064</b>    | \$ 5,752,354   |
| Total assets                            | \$ <b>6,184,373</b>   | \$ 16,845,182  | \$ <b>6,184,373</b>    | \$ 16,845,182  |
| Common shares                           |                       |                |                        |                |
| Outstanding                             | <b>49,469,218</b>     | 36,992,895     | <b>49,469,218</b>      | 36,992,895     |
| Weighted average – basic                | <b>49,423,218</b>     | 36,992,895     | <b>44,949,747</b>      | 33,632,848     |

# Primary Petroleum Corporation

Management's Discussion & Analysis  
For the Year Ended May 31, 2009

## Management's Discussion and Analysis

The following discussion and analysis ("Management's Discussion and Analysis") is dated and based on information at September 28, 2009, and is provided by the management of Primary Petroleum Corporation ("Primary" or the "Corporation") and prepared in accordance with the requirements of National Instrument 51-102 and Form 51-102F1. It should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended May 31, 2009.

The Company's consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles ("GAAP"). The reporting and the measurement currency in the audited financial statements and in this Management's Discussion and Analysis is the Canadian dollar.

## Additional Information

The information contained in this Management's Discussion and Analysis represents only a portion of current information available on Primary Petroleum Corporation. Readers are encouraged to read Primary's 2009 Annual Report and the Management Information Circular. These documents together with prior annual and quarterly reports, news releases and corporate presentations are available by visiting the Corporation's website at [www.primarypetroleum.com](http://www.primarypetroleum.com). Additional information regarding the Corporation, including all continuous disclosure documents, can be obtained on SEDAR at [www.sedar.com](http://www.sedar.com). If you require a hard copy of any of these documents please call the Corporation's main office number (403) 262-3132.

## Special Note

Disclosure provided herein in respect of barrels of oil equivalent ("Boe") may be misleading, particularly if used in isolation. A Boe conversion ratio for natural gas of 6 Mcf: 1 Bbl has been used and is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalent at the wellhead.

## Non- GAAP Measures

Management's Discussion and Analysis contains the term "funds from (used in) operations", which should not be considered an alternative to, or more meaningful than "cash flow from (used in) operating activities" as determined in accordance with GAAP as an indicator of the Corporation's financial performance. Funds from (used in) operations is determined by adding to cash flow from (used in) operations the change in working capital applicable to operating activities to cash flow from (used in) operations. Management believes that in addition to cash flow from operating activities, funds from operations is a useful supplemental measure as it provides an indication of the results generated by Primary's principal business activities before the consideration of how such activities are financed. The Corporation's determination of funds from operations may not be comparable to that reported by other companies.

The Management Discussion and Analysis uses the term "Operating Netback" which is a non-GAAP financial measurement. This term, which the Corporation believes provide useful and relevant information, should not be considered an alternative to, or more meaningful than "cash flow from operating activities" as determined in accordance with GAAP as an indicator of the Corporation's financial performance. Operating netbacks are calculated by deducing royalties and operating costs from revenues. The Corporation's determination of operating netbacks may not be comparable to that reported by other companies.

## Forward-looking Statements

Certain statements contained in this Interim Report constitute forward-looking statements. These statements relate to future events or the Corporation's future performance. All statements other than statements of historical fact may be forward-looking statements. Forward-looking statements are often, but not always, identified by the use of words such as "seek", "anticipate", "plan", "continue", "estimate",

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"expect", "may", "will", "project", "predict", "potential", "targeting", "intend", "could", "might", "should", "believe" and similar expressions. These statements involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements. The Corporation believes that the expectations reflected in those forward-looking statements are reasonable but no assurance can be given that these expectations will prove to be correct and such forward-looking statements included in this Management's Discussion and Analysis should not be unduly relied upon. These statements speak only as of the date of this Management's Discussion and Analysis.

In particular, this Management's Discussion and Analysis contains forward-looking statements pertaining to the following:

- The quantity of reserves;
- oil and natural gas production levels;
- capital expenditure programs;
- market prices and costs;
- supply and demand for oil and natural gas;
- operating, general and administrative and income tax expenses;
- operating netbacks;
- expectations regarding the Corporation's ability to raise capital and to continually add to reserves through acquisitions and development; and
- treatment under government regulatory and taxation regimes.

The Corporation's actual results could differ materially from those anticipated in these forward-looking statements as a result of the risk factors set forth below and elsewhere in this Management's Discussion and Analysis or this Report:

- volatility in market prices for oil and natural gas;
- liabilities and risks inherent in oil and natural gas operations;
- uncertainties associated with estimating reserves;
- competition for, among other things, capital, acquisitions of reserves, undeveloped lands and skilled personnel;
- incorrect assessments of the value of acquisitions; and
- geological, technical, drilling and processing problems.

## Liquidity and Capital Resources

Primary had a working capital deficiency of \$2,908,416 as at May 31, 2009, including a credit facility of \$2,040,000. On July 13, 2009, this deficiency was reduced by approximately \$1,645,000 from the sale of producing properties in the United States. The private placement proceeds of \$500,000 completed in early September, 2009 also contributed to a reduction of the Corporation's working capital deficiency. Certain financing arrangements that were announced in the fourth quarter of fiscal year 2009 did not come to fruition due mainly to the Corporation's going concern issues. The Corporation is continuing its efforts to dispose of non-core undeveloped lands in Montana and the disposition of certain producing properties in Canada.

The Corporation's capital expenditure program for the balance of calendar year 2009 will be focused on projects qualifying as flow-through expenditures.

There is significant doubt about the appropriateness of the use of the going concern assumption as the Corporation has a significant working capital deficiency of \$2,908,416 as at May 31, 2009, has incurred significant losses to date, has not been able to pay all of its accounts payable when due, in a market where the price of natural gas continues to decline thus reducing the Corporation's monthly cash flow.

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## Management's Discussion & Analysis For the Year Ended May 31, 2009

The future of the Corporation is dependant on the Corporation's success in obtaining the necessary funds to repay it's debts as they come due and to fund the development of its properties and fulfil its flow-through share obligations. The Corporation's working capital deficiency includes a demand loan of \$105,150 and a credit facility of \$2,040,000. The Corporation has negotiated an extension of the credit facility until March 31, 2010. The Corporation expects to reduce the credit facility with proceeds from the disposition of properties during the fiscal year 2010. (See Primary's Consolidated Financial Statements as at May 31, 2009, Note 17 - Subsequent Events). In addition, the Corporation has taken steps to reduce its overhead including reducing salaries and the termination of employees and reducing the burden of credit facility.

Management has been and continues to be active in seeking alternative sources of funding and disposition of assets to repay the credit facility and other obligations and to continue with its planned capital expenditure program.

### Financial Results

#### *Q4*

For the three months ended May 31, 2009, Primary recorded a net loss of \$3,495,667 (\$0.07 per share) compared to a net loss of \$1,221,339 (\$0.03 per share) for the corresponding period in fiscal year 2008. Funds used in operations for the fourth quarter of 2009 was \$619,344 (\$0.01 per share) versus funds used in operations \$492,301 (\$0.01 per share) in fiscal year 2008. Cash flow used in operating activities for the fourth quarter of 2009 was \$252,338 (\$0.00 per share) versus funds used in operations \$790,580 (\$0.02 per share) in fiscal year 2008. The amounts per share are based on a weighted average number of shares outstanding of 49,423,218 and for the last quarter of 2008 based on 36,992,895.

#### *YTD*

In the year ended May 31, 2009 the Corporation incurred a net loss of \$11,183,703 (\$0.25 per share) compared to the net loss of \$3,181,762 (\$0.09 per share) for the corresponding period in 2008. Funds used in operations during the year ended May 31, 2009 were \$884,659 (\$0.02 per share) compared to \$1,438,270 (\$0.04 per share) used in operations for the year ended May 31, 2008. Cash flow used in operating activities during the year ended May 31, 2009 were \$351,790 (\$0.01 per share) compared to \$1,491,682 (\$0.04 per share) used in operating activities for the year ended May 31, 2008. Per share amounts for 2009 are based on a weighted average number of shares outstanding of 44,949,747 and for 2008 based on 33,632,848.

### Volumes, Revenue and Prices

#### *Q4*

Sales volumes for the three months ended May 31, 2009 were 700 Mcf/d of natural gas or 117 Boe/d. During the fourth quarter of fiscal year 2008 sales volumes were 1,012 Mcf/d of natural gas and 5 Bbls/d or oil and NGLs or 174 Boe/d.

Oil and gas revenues for the last quarter of fiscal year 2009, were \$238,128 compared to \$601,819 for the corresponding period in fiscal year 2008. The decrease is due to lower commodity prices and a decline in Canadian sales volumes as these wells require remedial work to re-establish production volumes to previous levels. The Corporation received an average price of \$3.70/Mcf of natural gas during the three months ended May 31, 2009. For the same period of fiscal year 2008, Primary received an average price \$5.99 per Mcf of natural gas and \$59.90 for its oil and NGL production.

#### *YTD*

Volumes for the year ended 2009 averaged 564 Mcf/d of natural gas and 3 Bbls/d of oil and NGLs or 97 Boe/d. For the previous year, sales volumes averaged 712 Mcf/d of natural gas and 2 Bbls/d of oil and NGLs or the equivalent of 120 Boe/d.

Revenues for the fiscal year 2009 were \$1,423,450 which is a 7% increase over the \$1,327,277 reported for the corresponding period in fiscal year 2008. The increase resulted from high commodity prices in the

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## Management's Discussion & Analysis For the Year Ended May 31, 2009

initial months of fiscal year 2009, which declined as the year progressed, offset by declining production volumes throughout the year. Average prices for 2009 were \$6.29/Mcf of natural gas and \$114.60/Bbl. The Corporation received an average \$4.93/Mcf of natural gas and \$59.90/Bbl of oil and NGLs during the fiscal year 2008. The price declines experienced by the Corporation are consistent with commodity price declines published by independent third party sources.

### **Royalties**

#### ***Q4***

Royalties averaged 14% of revenues or \$3.01/Boe for the three months ended May 31, 2009 compared to royalties for the fourth quarter of fiscal year 2008 which averaged \$8.01/Boe or 22% of revenues. The decline is primarily due the payout of the Swimming 10-28 well early in fiscal year 2009 resulting in the joint venture partner converting from their 15% overriding royalty to a 50% working interest.

#### ***YTD***

For the year 2009 royalties averaged 16% or \$6.45/Boe versus 29% or \$14.32 for 2008. The lower rate is attributed the conversion of a 15% overriding royalty to a working interest, increased production in Canada from the Corporation's Twin Lake well in Alberta which had a lower royalty rate than Montana wells, and by the Canada/United States exchange rate.

### **Operating Expenses**

#### ***Q4***

Operating expenses for the last quarter of fiscal year 2009 were \$10.89/Boe compared \$2.95/Boe three months ended May 31, 2008. The increase in the Boe rate is due to the high processing and gathering fees charged on the Corporation's production from its Twin Lakes well in east central Alberta, which are substantially higher than that incurred for the Corporation's other producing properties.

#### ***YTD***

For the year ended May 31, 2009, operating costs averaged \$9.79/Boe versus \$5.80/Boe for the year ended May 31, 2008. The combination of high processing and gathering fees for the Corporation's Twin Lakes well and the Canada/U.S. exchange rate contributed to the higher cost in 2009.

### **Operating Netbacks**

#### ***Q4***

During the last quarter of fiscal year 2009, operating netbacks (oil and gas revenues net of royalties and operating costs) averaged \$8.29/Boe compared to \$26.08/Boe for the corresponding period in fiscal year 2008. Declining commodity prices, increasing operating costs, the Canada/United States exchange rate, partially offset by lower royalty rates contributed to the lower netbacks in Q4/09.

#### ***YTD***

During fiscal year 2009, operating netbacks declined to \$23.91/Boe from the \$28.87/Boe reported for 2008. Declining commodity prices, increasing operating costs, the Canada/United States exchange rate, partially offset by lower royalty rates contributed to the lower netbacks in 2009.

### **General and Administrative Expenses**

#### ***Q4***

As a junior oil and gas company in its early years of development, general and administrative expenses as a percentage of revenue or as a per unit cost of production are significantly higher than those of an established oil and gas company. For the fourth quarter of 2009, general and administrative costs, net of capitalized costs, were \$339,722 compared to \$620,101 for the last quarter of fiscal year 2008. Commencing in fiscal year 2009 Primary commenced capitalizing certain general and administrative costs

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## Management's Discussion & Analysis For the Year Ended May 31, 2009

related to the development of future exploration and development prospects. These costs amounted to \$73,926 for Q4/09. The Corporation began reducing its general and administrative expenses during the fourth quarter in an effort to increase cash flow and reducing the Corporation's working capital deficiency.

### *YTD*

During the fiscal year ended May 31, 2009, Primary incurred \$1,177,267 of general and administrative costs, net of capitalized costs of \$351,772. Costs for fiscal year 2008, were \$1,904,356 during which costs related to exploration and development activities were expensed. The decline in gross costs in 2009 is due to reduced personnel and public entity costs such as investor relations and legal fees.

### **Stock Based Compensation Expense**

Stock based compensation expense represents the amortization of the fair value of stock options issued to directors, employees and consultants, over the vesting period of the options. The Corporation recorded a recovery of stock based compensation expense of \$299,710 during the three months ended May 31, 2009 compared to an expense of \$138,010 for the three months ended May 31, 2008. The recovery in the fourth quarter of 2009 is the result of revaluing stock options granted to consultants. For the year ended 2009 Primary recorded stock based compensation expense of \$64,338 compared to \$324,105 for the corresponding period in 2008. The reduction in stock based compensation for 2009 is due to the 1,775,000 options forfeited during the year which resulted in a recovery of a portion of stock based compensation recorded in 2008.

### **Interest and Accretion Expense**

#### *Q4*

Interest expense of \$110,701 in Q4/09 relates principally to the Corporation's credit facility. Interest expense for Q4/08 of \$327,045 is a combination of \$185,000 of costs relate to the \$2,000,000 credit facility, a financing charge related to the extension of the \$2,250,000 of convertible notes and interest on the two facilities.

#### *YTD*

In 2009, the Corporation incurred interest expense of \$506,641 compared to interest and accretion expense of \$409,882 for fiscal year 2008. Interest expense for 2009 relates the Corporation's credit facility and costs associated with the Corporation's unsuccessful efforts to establish a line of credit with a financial institution. The interest expense and costs incurred in fiscal year 2008 were related to the Corporation's credit facility and its convertible notes.

### **Depletion, Depreciation and Accretion**

#### *Q4*

Depletion, depreciation and accretion expense for the three months ended May 31, 2009 was \$457,138 (Canada - \$71,906, United States - \$385,232) compared to \$213,299 (Canada - \$136,076, United States - \$176,223) for the last quarter of fiscal year 2008. The decrease in Canada is related to declines in production and the write-down of property and equipment in the third quarter. The increase in the United States is due to the reduction of the Corporation's reserves in the United States as at May 31, 2009, resulting in expensing the remaining depletable asset base.

#### *YTD*

For the year ended May 31, 2009, Primary recorded depletion, depreciation and accretion expense of \$1,215,811 (Canada - \$372,715; United States - \$843,096) compared to depletion, depreciation and accretion expense of \$925,317 (Canada - \$683,068, United States - \$245,249) for the fiscal year ended May 31, 2008. The decrease in Canada is a result of the write-down recorded in the third quarter. The increase in the United States is due to the non-evaluation of the Corporation's reserves in the United States as at May 31, 2009, resulting in the expensing of the remaining depletable base.

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For the Year Ended May 31, 2009

## Write-down of Property and Equipment

The Corporation performed ceiling test calculations at May 31, 2009 to assess whether the carrying value of the property and equipment were recoverable. At May 31, 2009, the Corporation recognized a reduction in the value of its proved plus probable reserves in Canada and the United States and a reduction in the value of its undeveloped properties. As a result the Corporation recorded a write-down of \$9,223,000 (Canada \$1,300,000, United States \$7,923,000) in the carrying value of its property and equipment.

## Income Taxes

The Corporation has an unrecorded future income tax asset that has not been recognized in previous years. The issuance of flow-through common shares and the subsequent renunciation of flow-through expenditures as at December 31, 2008 gave rise to a reduction of the unrecorded future tax asset which has been recognized in the financial statements as a recovery of income taxes in the current fiscal period in the amount of \$156,250.

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes.

## Outlook

During the last year the oil and gas industry has experienced a significant decline in commodity prices from the highs experienced earlier in 2008. The commodity price for natural gas has yet to stabilize and has continued to decline in the first quarter of fiscal year 2010. This decline has resulted in a significant reduction in Primary's revenue stream and created a situation that makes it difficult for Primary to meet its obligations. Gas prices are not expected to significantly increase in the near future which has prompted Primary to undertake the disposition of its major producing property in the United States early in fiscal year 2010. This allowed Primary to reduce its credit facility with Ionic Capital Corp. by approximately \$1.3 million to \$700,000 and reduce the future associated interest burden. The reduction in the credit facility is permanent as the facility is not renewable. Revenues for the first half of fiscal year 2010 are expected to be negligible as the Corporation plans to sell its remaining producing properties to eliminate the credit facility and reduce its other liabilities. Production beyond the first half is contingent on drilling successes.

Throughout fiscal year 2009 the Corporation has been confronted with the issue of being a viable going concern. This concern has been reduced, not eliminated, and the Corporation now finds itself in a start-up position with significant land holdings in Montana along with certain lands in Alberta. The current plan is to seek investors and or industry participants to invest in the Corporation's exploration oil prospect in Saturn area of Montana where existing well control indicates large accumulations of oil and high producing wells. The need for a 3D seismic program will provide additional information as the viability of the prospect. Other prospect areas in Montana include Teton, Tiber and Pondera. The Corporation is required to incur an additional \$375,000 of exploration expenditures in Canada to fulfill its remaining obligation to subscribers of its flow-through share financing late in 2008 and continues to review viable prospects.

Operating costs are not expected to have an impact on the Corporation's foreseeable future until prospects are drilled with success and production is brought on stream.

Commencing in the fourth quarter of fiscal year 2009 and continued into the Q1 2010 the Corporation has taken steps to significantly reduce its general and administrative costs which are not expected to increase during the next six to nine months.

As Primary's debt has declined significantly in the first quarter of fiscal year 2010 and is expected to be repaid by March 31, 2010. Interest expense is expected to be eliminated thereafter.

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## Management's Discussion & Analysis For the Year Ended May 31, 2009

### Capital Expenditures

In the three months and year ended May 31, 2009, Primary incurred (recovered) capital expenditures of (\$132,606) and \$1,241,064 respectively. This compares to \$790,379 and \$5,752,354 respectively, for the corresponding periods for fiscal year 2008.

Capital expenditures for the three months and year ended May 31, 2009 and 2008 were as follows:

|  | Three months ended  |                   | Year ended May 31,  |                     |
|--|---------------------|-------------------|---------------------|---------------------|
|  | May 31,<br>2009     | 2008              | 2009                | 2008                |
| Land                                   | \$ 44,010           | \$ 276,894        | \$ 195,402          | \$ 1,791,750        |
| Geological and geophysical             | 7,745               | 8,960             | 331,578             | 1,223,817           |
| Intangible drilling and completions    | (265,372)           | 444,175           | 3,442               | 2,649,972           |
| Equipment and facilities               | 7,085               | 59,184            | 357,921             | 73,016              |
| Capitalized general and administrative | 73,926              | -                 | 351,772             | -                   |
| Furniture and equipment                | -                   | 1,166             | 949                 | 13,799              |
| <b>Net change</b>                      | <b>\$ (132,606)</b> | <b>\$ 790,379</b> | <b>\$ 1,241,064</b> | <b>\$ 5,752,354</b> |

The negative amount of intangible drilling and completions for three months ended May 31, 2009 resulted from the settlement of a long standing dispute with the operator, associated with wells drilled in prior years. The operator agreed to reverse certain unauthorized costs previously charged to the Corporation resulting in the Corporation recording the reversal of these previously recorded costs in the fourth quarter of fiscal year 2009.

### Share Capital Data

The Corporation is authorized to issue an unlimited number of common voting shares. At May 31, 2009 the Corporation's issued and outstanding common shares were 49,469,218. During fiscal year 2009 the Corporation issued 6,105,051 shares at \$0.40 per share on redemption of the convertible note and accrued interest, 6,250,000 at \$0.10 per share on a flow-through basis and 121,272 shares at a deemed value of \$0.03 per share on the acquisition of lands.

The following table summarizes share capital for the two years ended May 31, 2009:

|   | Number<br>of shares | Amount       |
|---|---------------------|--------------|
| Balance, May 31, 2007   | 26,918,317          | \$ 8,835,739 |
| Issued for cash on initial public offering                    | 8,500,000           | 7,325,473    |
| Fair value of warrants issued on initial public offering      | -                   | (1,847,705)  |
| Issued as corporate finance fee                               | 100,000             | 100,000      |
| Issued for corporate acquisition                              | 1,205,049           | 641,524      |
| Issued for finders fee related to acquisition                 | 269,529             | 169,803      |
| Balance, May 31, 2008   | 36,992,895          | 15,224,834   |
| Issued on redemption of convertible note and accrued interest | 6,105,051           | 2,809,738    |
| Private placement of flow-through shares for cash             | 6,250,000           | 625,000      |
| Shares issued on acquisition of lands                         | 121,272             | 3,638        |
| Share issue costs   | -                   | (44,148)     |
| Tax effect of flow-through shares                             | -                   | (156,250)    |
| Balance, May 31, 2009   | 49,469,218          | \$18,462,812 |

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## Related Party Transactions

For the three months ended May 31, 2009 and 2008, remuneration to management totaling \$121,742 and \$72,000 respectively, were charged to the Corporation by companies controlled by directors and officers of the Corporation. For the year end May 31, 2009 and 2008, management fees totaling \$455,830 and \$252,000 respectively, were charged to the Corporation by companies controlled by directors and officers of the Corporation.

On May 26, 2009, the Corporation entered into a demand loan agreement with a syndicate of individuals in the amount of \$105,150. Included in the syndicate are three directors of the Corporation whose share of the loan proceeds was \$65,150.00. The loan bears interest at 12% per annum, compounded and payable semi-annually. The demand loan is repayable by the Corporation at any time without penalty. No interest was paid during the year ended May 31, 2009.

Legal fees of \$7,599 (2008 – \$1,884) were charged to the Corporation by a legal firm of which a director of the Corporation is a member.

Pursuant to an agreement dated May 31, 2005 an officer and director of the Corporation is to receive a gross overriding royalty of 1% on certain oil and gas revenue produced from the Pondera and Teton prospect areas in Montana. The Corporation has the right to purchase two-thirds of the gross overriding royalty for cash or common shares of the Corporation as determined by an independent valuation. No royalties have been paid to date.

## Off Balance Sheet Arrangements

The Corporation does not have any special purpose entities nor is it party to any arrangement that would be excluded from the balance sheet.

## Contractual Obligations

Pursuant to an agreement dated July 26, 2006, the Corporation committed to purchase a minimum of 100,000 and up to 300,000 net mineral acres in Montana, with a net revenue interest of not less than 85% to the Corporation, at a cost of US \$12.50 per acre plus the issue of one-half of a common share of the Corporation for each acre acquired. As at May 31, 2009, 80,847 acres have been acquired. The Corporation received a ruling from the Montana courts that it has been relieved of any further commitment under this agreement.

Pursuant to an agreement dated August 31, 2006, a finder's fees is payable by the Corporation upon the completion of certain Powder River prospect land acquisitions in Montana. The fees are payable on the basis of the issuance of one common share of the Corporation for each acre acquired.

Prior to the end of calendar year 2008, the Corporation issued 6,250,000 shares on a flow-through basis for gross proceeds of \$625,000. Effective December 31, 2008, the Corporation renounced \$625,000 of Canadian exploration expenditures to the subscribers of the flow-through shares. At May 31, 2009, the Corporation had incurred \$260,000 of Canadian exploration expenditures and has plans to incur a minimum of \$365,000 of Canadian exploration expenditures by December 31, 2009.

Pursuant to the credit facility amending agreement dated May 27, 2009, the Corporation agreed to pay to Ionic Capital Corp. the net sale proceeds from the sale of any of its properties. (See Primary's Consolidated Financial Statements as at May 31, 2009, Note 17 - Subsequent Events). The Corporation is required to pay interest monthly on the outstanding balance at a rate of 18% until the credit facility is fully paid. As the credit facility is repaid the amount of the facility is permanently reduced and is not subject to renewal. The credit facility expires on March 31, 2010.

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The Corporation has a five year lease agreement expiring March 1, 2012 with a minimum obligation of \$123,172 per annum, excluding operating costs.

## **Application of Critical Accounting Estimates**

Critical Accounting Estimates

### *Full Cost Accounting Guideline AcG-16*

For purposes of financial statements, companies are required to review the carrying value of their assets relative to their recoverable amount. Under the Full Cost Accounting Guideline AcG-16 the guideline amends the ceiling test calculation to be a two part process. The first part, the recognition of impairment, is determined by comparing the carrying amount of petroleum and natural gas properties and equipment to the sum of the undiscounted cash flows expected to result from the Corporation's proved reserves. Cash flows are calculated based on third party quoted forward prices, adjusted for the Corporation's contract prices and quality differentials. If there is impairment, the second part of the calculation would measure the magnitude of the impairment by comparing the carrying amount of petroleum and natural gas properties and equipment to the estimated net present value of future cash flows from proved plus probable reserves. A risk free interest rate is used to arrive at the net present value of the future cash flows. Any excess carrying value above the net present value of the future cash flows would be recorded as a permanent impairment and charged as additional depletion, depreciation and accretion expense in the statement of operations.

### *Petroleum and Natural Gas Reserves*

For the year ended May 31, 2009 only Primary's Canadian petroleum and natural gas reserves were evaluated and reported on by independent petroleum engineers. The estimation of reserves is a subjective process. Forecasts are based on engineering data, projected future rates of production, and the timing of future expenditures, all of which are subject to numerous uncertainties and various interpretations. The Corporation expects that its estimates of reserves will change to reflect updated information. Reserve estimates can be revised upward and downward based on the results of future drilling, testing or production levels.

### *Depletion, Depreciation and Accretion Expense*

The Corporation uses the full cost method of accounting for exploration and development activities whereby all costs associated with these activities are capitalized, whether successful or not. The aggregate of capitalized costs, net of certain costs related to unproved properties, and estimated future development costs is amortized using the unit-of-production method based on estimated proved reserves. Changes in estimated proved reserves or future development costs have a direct impact on depletion and depreciation expense.

Certain costs related to unproved properties and major development projects may be excluded from costs subject to depletion until proved reserves have been determined or their value is impaired. These properties are reviewed quarterly to determine if proved reserves should be assigned, at which point they would be included in the depletion calculation, or for impairment which would be included in depletion and depreciation expense.

### *Stock Based Compensation*

The Corporation uses the Black-Scholes valuation model to estimate the fair value of the stock options granted and to revalue the fair value each reporting period to those stock options granted to consultants.

## **New Accounting Standards - Adopted**

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On June 1, 2008, the Corporation adopted the new accounting standards for Financial Risk Exposure, Capital Management and Fair Value Financial Instruments. The adoption of these accounting standards had no material impact on the Corporation's net income or cash flows.

### *Financial Risk Exposure*

The new standard requires identification and disclosure of the principal financial risks faced by the Corporation in the course of its activities. These risks include credit risk, liquidity risk and market risk including commodity price risk, foreign exchange risk and interest rate risk.

### *Capital Management*

The new standard requires disclosure as to the capital structure by the Corporation to ensure a strong capital base is maintained and disclosure of the measurement criteria by the Corporation to monitor the strength of the Corporation's capital structure.

### *Financial Instruments – Fair Value*

The new standard requires the identification of all financial instruments and the allocation of those instruments into one of five categories. The financial instruments are initially recognized at fair value and subsequently as appropriate for each specific category. The Corporation's financial assets and liabilities carrying values approximate the fair values due to the short-terms to maturity.

## **Future New Accounting Standards**

### *International Accounting Standards*

The AcSB has adopted a strategic plan for the direction of accounting standards in Canada. Accounting standards for public companies in Canada will converge with the International Financial Reporting Standards ("IFRS") by 2011. IFRS will replace Canadian GAAP with the official change over to IFRS to occur for interim and annual financial statements relating to fiscal years beginning on or after January 1, 2011. The Corporation is engaged in preparing for this transition through the process of reviewing various publications, determining the effect on the Corporation's current reporting processing, and setting time lines and processes for adoption of IFRS and the preparation of financial statements under IFRS for comparative purposes in 2011.

In January, 2009, the AcSB issued Section 1582, Business Combinations, which replaces former guidance on business combinations. Section 1582 establishes principles and requirements of the acquisition method for business combinations and related disclosures. This statement applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after January, 2011 with earlier application permitted. Primary plans to adopt this standard prospectively effectively June 1, 2009 and does not expect the adoption of this statement to have a material impact on our results of operations or financial position.

In January, 2009, the AcSB issued Sections 1601, Consolidated Financial Statements, and 1602, Non-controlling Interests, which replaces existing guidance. Section 1601 establishes standards for the preparation of consolidated financial statements. Section 1602 provides guidance on accounting for a non-controlling in a subsidiary in consolidated financial statements subsequent to a business combination. These standards are effective on or after the beginning of the first annual reporting period beginning on or after January 2011 with earlier application permitted. Primary plans to adopt these standards effective June 1, 2009 and does not expect the adoption will have a material impact on our results of operations of financial position.

## **Risks**

The following is a summary of the various risks that are associated with exploration, development and production of oil and natural gas. Exploration for oil and natural gas involves many risks, which even a combination of experience, knowledge and careful evaluation may not be able to overcome. There is no assurance that further commercial quantities of oil and natural gas will be discovered by the Corporation.

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The following review and commentary cannot be considered exhaustive as the Corporation cannot foresee what new and novel risks may emerge overtime that could adversely impact the Corporation or its assets.

### *Exploration, Development and Production*

Oil and natural gas operations involve many risks that even a combination of experience, knowledge and careful evaluation may not be able to overcome. The long term commercial success of the Corporation depends on its ability to find, acquire, develop and commercially produce oil and natural gas reserves. Without the continuous addition of new reserves, any existing reserves the Corporation may have at any particular time, and the production there from will decline over time as such existing reserves are exploited. A future increase in the Corporation's reserves will depend not only on its ability to explore and develop any properties it may have from time to time, but also on its ability to select and acquire suitable producing properties or prospects. No assurance can be given that the Corporation will be able to continue to locate satisfactory properties for acquisition or participation. Moreover, if such acquisitions or participations are identified, management of the Corporation may determine that current markets, terms of acquisition and participation or pricing conditions make such acquisitions or participations uneconomic. This is not assurance that further commercial quantities of oil and natural gas will be discovered or acquired by the Corporation.

Future oil and natural gas exploration may involve unprofitable efforts, not only from dry wells, but also from wells that are productive but do not produce sufficient petroleum substances to return a profit after drilling, operating and other costs. Completion of a well does not assure a profit on the investment or recovery of drilling, completion and operating costs. In addition, drilling hazards or environmental damage could greatly increase the cost of operations, and various field operating conditions may adversely affect the production from successful wells. These conditions include delays in obtaining governmental approvals or consents, shut-ins of connected wells resulting from extreme weather conditions, insufficient storage or transportation capacity or other geological and mechanical conditions. While diligent well supervision and effective maintenance operations can contribute to maximizing production rates over time, production delays and declines from normal field operating conditions cannot be eliminated and can be expected to adversely affect revenue and cash flow levels to varying degrees.

Oil and natural gas exploration involves a high degree of risk and there is no assurance that expenditures made on exploration by Primary will result in new discoveries of oil or natural gas in commercial quantities. It is difficult to project the costs of implementing an exploratory drilling program due to the inherent uncertainties of drilling in unknown formations, the costs associated with encountering various drilling conditions such as over pressured zones and tools lost in the hole, and changes in drilling plans and locations as a result of prior exploratory wells or additional seismic data and interpretation thereof. Future oil and natural gas exploration may involve unprofitable efforts, not only from dry wells, but from wells that are productive but do not produce sufficient net revenues to return a profit after drilling, operating and other costs.

### *Expiration of Licences and Leases*

The Corporation's properties are held in the form of licences and leases and working interests in licences and leases. If the Corporation or the holder of the licence or lease fails to meet the specific requirements of a licence or lease, the licence or lease may terminate or expire. There can be no assurance that any of the obligations required to maintain each licence or lease will be met. The termination or expiration of the Corporation's licences or leases or the working interests relating to a licence or lease may have a material adverse effect on the Corporation's business, financial condition, results or operations and prospects.

### *Global Financial Crisis*

Recent market events and conditions, including disruptions in the international credit markets and other financial systems and the deterioration of global economic conditions, have caused significant volatility in commodity prices. These conditions worsened in 2008 and are continuing into 2009, causing a loss of confidence in the broader U.S. and global credit and financial markets and resulting in the collapse of, and government intervention in, major banks, financial institutions and insurers and creating a climate of

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greater volatility, less liquidity, widening of credit spreads, a lack of price transparency, increased credit losses and tighter credit conditions. Notwithstanding various actions and interventions by governments, concerns about the general condition of the capital markets, financial instruments, banks, investment banks, insurers and other financial institutions caused the broader credit markets to further deteriorate and stock markets to decline substantially. These factors have negatively impacted company valuations and will impact the performance of the global economy going forward.

Petroleum prices are expected to remain volatile for the near future as a result of market uncertainties over the supply and demand for these commodities due to the current state of the global economies, OPEC actions and the ongoing global credit and liquidity concerns.

### *Operating Hazards*

Oil and natural gas operations are subject to the risks of exploration, development and production of oil and natural gas properties including encountering unexpected formations or pressures critical sour operations, premature declines of reservoirs, blow outs, craters, sour gas release, fires and spills, losses resulting from the occurrence of any of these risks could have a material adverse effect on future results of operations, liquidity and financial condition.

### *Reserve Estimates*

There are numerous uncertainties inherent in estimating quantities of oil, natural gas and natural gas liquids and the future cash flows to be derived there from, including many factors beyond our control. The reserves and associated cash flows are estimates only. The Corporation's actual production, revenues, taxes and development and operating expenditures with respect to its reserves will vary from estimates and such variations could be material.

### *Capital Requirements; Liquidity*

The Corporation will need additional financing to fund its fiscal 2010 capital expenditure program and other costs. The development of Primary's oil and gas projects, will require additional funding. Primary's future operations are dependent upon its ability to continue to obtain financing and ultimately achieve profitable operations. Additional capital may be in the form of equity, debt, sale of properties, joint venture farmouts or any combination thereof.

### *Industry Factors*

The crude oil and natural gas industry is highly competitive and the Corporation must compete with many companies with greater financial and technical resources. Generally, there is intense competition for the acquisition of resource properties considered to have commercial potential. The marketability and price of crude oil and natural gas which may be acquired or discovered by the Corporation will be affected by numerous factors beyond the control of the Corporation. The ability of the Corporation to market its natural gas may be dependent upon its ability to acquire space on pipelines which deliver natural gas to commercial markets. Prices paid for both crude oil and natural gas produced are subject to market fluctuations which will directly affect the profitability of producing any crude oil or natural gas reserves which may be acquired or developed by the Corporation. The oil and natural gas industry has been subject to considerable price volatility over which companies have little control. A material decline in prices could result in a decrease in Primary's production revenue and its viability as a going concern. The oil and natural gas industry is also subject to extensive government policies and regulations, which result in additional cost and risk for industry participants.

### *Kyoto Protocol*

Canada is a signatory to the United Nations Framework Convention on Critical Change and has ratified the Kyoto Protocol established there under, to set legally binding targets to reduce nationwide emissions of carbon dioxide, methane, nitrous oxide and other so-called "greenhouse gases". Industry exploration and production facilities and other operations and activities emit greenhouse gases which will require industry to comply with the new regulatory framework announced on March 10, 2008 by the Federal Government,

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which is intended to force large industries to reduce emissions of greenhouse gases, in addition to the proposed *Clean Air Act* (Canada) of 2006 and Alberta's recently enacted *Climate Change and Emissions Management Act and Specified Gas Emitters Regulation*. The direct and indirect costs of these regulations may have a material adverse effect on the Corporation's business, financial condition, results of operations and prospects.

### *Environmental*

All phases of the oil and natural gas industry present environmental risks and hazards and are subject to environmental regulation pursuant to a variety of federal, provincial and local laws and regulations. Environmental legislation provides for, among other things, restrictions and prohibitions on spills, releases or emissions of various substances produced in association with oil and natural gas operations. The legislation also requires that wells and facility sites be operated, maintained, abandoned and reclaimed to the satisfaction of applicable regulatory authorities. Compliance with such legislation can required significant expenditures and a breach of applicable environmental legislation may result in the imposition of fines and penalties, some of which may be material. Environmental legislation is evolving in a manner expected to result in stricter standards and enforcement, larger fines and liability and potentially increased capital expenditures and operating costs. The discharge of oil, natural gas or other pollutants into the air, soil or water may give rise to liabilities to governments and third parties and may require the Corporation to incur costs to remedy such discharge. Although the Corporation believes that it is in material compliance with current applicable environmental regulations no assurance can be given that environmental laws will not result in a curtailment of production or a material increase in the costs of production, development or exploration activities or otherwise have a material adverse effect on the Corporation's business, financial condition, results of operations and prospects.

### *Geo-political Risks*

The marketability and price of oil and natural gas that may be acquired, discovered and produced by the Corporation is and will continue to be affected by political events throughout the world that cause disruptions in the supply of oil. Conflicts, or conversely peaceful developments, arising in the Middle-East, and other areas of the world, have a significant impact on the price of oil and natural gas. Any particular event could result in a material decline in prices and therefore result in a reduction of the Corporation's production revenues.

### *Reliance on Key Personnel*

The Corporation's success depends, to a significant extent, upon management and key employees. There is no assurance that the Corporation will successfully retain existing personnel or attract additional personnel required to continue to expand its business and to successfully execute its business strategy.

### *Dependence on Economic Conditions*

The Corporation's success in its marketing efforts of its products will be dependent to some extent upon the economic conditions affecting marketplace. The Corporation has no control over economic conditions.

### *Operational Matters*

The Corporation does not operate all of its oil and natural gas wells and accordingly the ability of the Corporation to produce such wells and market its share of production is dependent upon third party operators over which it does not have any control.

## **Selected Quarterly Information**

The following table sets forth selected information of the Corporation for each financial quarter for the period June 1, 2007 to May 31, 2009.

|                      | Fiscal Year Ended May 31, 2009 |    |    |    | Fiscal Year Ended May 31, 2008 |    |    |    |
|----------------------|--------------------------------|----|----|----|--------------------------------|----|----|----|
|                      | Q4                             | Q3 | Q2 | Q1 | Q4                             | Q3 | Q3 | Q1 |
| <b>Sales Volumes</b> |                                |    |    |    |                                |    |    |    |

# Primary Petroleum Corporation

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|  |            |            |           |           |            |           |           |           |
|--|------------|------------|-----------|-----------|------------|-----------|-----------|-----------|
| Oil and NGLs (Bbls/d)                                    | -          | -          | 7         | 7         | 5          | -         | -         | -         |
| Natural gas (Mcf/d)                                      | 700        | 505        | 519       | 532       | 1,012      | 612       | 340       | 336       |
| Barrels of oil equivalent (Boe/d)                        | 117        | 84         | 94        | 96        | 174        | 103       | 57        | 56        |
| <b>Financial</b>   |            |            |           |           |            |           |           |           |
| Oil and gas revenues (\$000)                             | \$ 238     | \$ 270     | \$ 374    | \$ 541    | \$ 601     | \$ 399    | \$ 162    | \$ 164    |
| Funds from (used in) operations (\$000)                  | \$ (324)   | \$ (229)   | \$ (60)   | \$ 23     | \$ 492     | \$ (247)  | \$ (439)  | \$ (280)  |
| Per Share – basic and diluted                            | \$ (0.01)  | \$ (0.00)  | \$ (0.00) | \$ 0.00   | \$ (0.00)  | \$ (0.01) | \$ (0.01) | \$ (0.01) |
| Cash flow from (applied to) operating activities (\$000) | \$ (135)   | \$ (194)   | \$ (223)  | \$ 318    | \$ (791)   | \$ 364    | \$ (775)  | \$ (240)  |
| Per Share – basic and diluted                            | \$ (0.00)  | \$ (0.00)  | \$ (0.01) | \$ 0.01   | \$ (0.02)  | \$ 0.01   | \$ (0.02) | \$ (0.01) |
| Net loss (\$000)   | \$ (3,496) | \$ (7,022) | \$ (361)  | \$ (305)  | \$ (1,221) | \$ (618)  | \$ (723)  | \$ (696)  |
| Per Share – basic and diluted                            | \$ (0.07)  | \$ (0.14)  | \$ (0.01) | \$ (0.01) | \$ (0.03)  | \$ (0.02) | \$ (0.02) | \$ (0.03) |
| Capital expenditures (\$000)                             | \$ (133)   | \$ 541     | \$ 187    | \$ 646    | \$ 790     | \$ 2,116  | \$ 1,855  | \$ 991    |
| Shares outstanding (000)                                 | 49,469     | 49,348     | 48,648    | 43,098    | 36,993     | 36,993    | 35,518    | 26,918    |
| <b>Per Unit Information</b>                              |            |            |           |           |            |           |           |           |
| Prices   |            |            |           |           |            |           |           |           |
| Oil and NGLs (\$/Bbl)                                    | \$ -       | \$ -       | \$ 94.41  | \$ 118.91 | \$ 59.90   | \$ -      | \$ -      | \$ -      |
| Natural gas (\$/Mcf)                                     | \$ 3.70    | \$ 5.93    | \$ 6.61   | \$ 9.51   | \$ 5.99    | \$ 7.16   | \$ 5.25   | \$ 5.31   |
| Oil equivalent (\$/Boe)                                  | \$ 22.19   | \$ 35.60   | \$ 43.88  | \$ 61.59  | \$ 37.04   | \$ 42.96  | \$ 31.51  | \$ 31.88  |
| Operating netback (\$/Boe)                               | \$ 8.29    | \$ 20.06   | \$ 27.54  | \$ 42.30  | \$ 26.08   | \$ 24.62  | \$ 10.28  | \$ 14.96  |

September 25, 2009